

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

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**Illinois Commerce Commission**  
**On its Own Motion**

**-vs-**

**Consumers Gas Company**

**Reconciliation of revenues collected  
under gas adjustment charges with  
actual costs prudently incurred.**

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**Docket No. 07-0570**

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**REPLY BRIEF OF THE STAFF**  
**OF THE ILLINOIS COMMERCE COMMISSION**

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Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, pursuant to Section 200.800 of the Rules of Practice (83 Ill. Adm. Code 200.800) of the Illinois Commerce Commission (“Commission”), respectfully submits its Reply Brief (“RB”) in the above-captioned matter.

**I. INTRODUCTION**

**A. PROCEDURAL BACKGROUND**

Staff’s Initial Brief (“IB”) was filed and served on Consumers Gas Company (“Consumers” or “Company”) and the Administrative Law Judge (“ALJ”) on May 10, 2013. Consumers also filed and served its IB in this matter on the same day. Many of the issues raised in Consumers’ IB were addressed in Staff’s IB. The absence of a response to a specific issue raised in Consumer’s IB in this RB does not constitute a change of position from the Staff IB. Staff’s RB follows.

## B. LEGAL STANDARDS

In the legal standards section of its IB, Consumers cites to Section 9-220 of the Illinois Public Utilities Act ("Act") and the Commission standard for prudence set forth in its order in Docket No. 84-0395. (Consumers IB, p. 5) Staff agrees with Consumers that Section 9-220 of the Act and the Commission's standard for prudence set forth in the Commission's final Order in Docket No. 84-0395<sup>1</sup> are two legal standards at issue in this proceeding; however, as set forth in the Staff IB, Section 7-101(3) of the Act is also very relevant to this proceeding. In particular, two provisions from Section 7-101(3) are critical to this matter. Those provisions are underlined and set forth below.

No management, construction, engineering, supply, financial or similar contract and no contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission or is exempted in accordance with the provisions of this Section or of Section 16-111 of this Act. The Commission may condition such approval in such manner as it may deem necessary to safeguard the public interest. If it be found by the Commission, after investigation and a hearing, that any such contract or arrangement is not in the public interest, the Commission may disapprove such contract or arrangement. Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.

The consent to, or exemption or waiver of consent to, any contract or arrangement under this Section or Section 16-111, does not constitute approval of payments thereunder for the purpose of computing expense of operation in any rate proceeding. However, the Commission shall not require a public utility to make purchases at prices exceeding the prices offered by an affiliated interest, and the Commission shall not be required to disapprove or disallow, solely on the ground that such payments yield the affiliated interest a return or rate of return in excess of that allowed the

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<sup>1</sup> Staff also cited to the Commission's order in Docket No. 88-0142 for its understanding of the Commission's standard for prudence. (Staff IB, p. 25)

public utility, any portion of payments for purchases from an affiliated interest.

(220 ILCS 5/7-101(3)) (Emphasis added) With respect to the first provision, Consumers in its IB fails to acknowledge that absent Commission approval, the hedging contract between Egyptian Gas Storage (“Egyptian” or “EGS”) and Consumers is void and no costs from the void contract can be recovered through rates. (Staff IB, pp. 18-19) With respect to the second provision, Consumers fails to recognize that even if the Commission finds that the hedging transaction was permitted by the affiliate agreement, which it should not and which would be a complete reversal of its decision in Docket No. 06-0744 (Staff IB, p. 18), that “[t]he consent to, or exemption or waiver of consent to, any contract or arrangement under this Section [7-101(3)] or Section 16–111, does not constitute approval of payments thereunder for the purpose of computing expense of operation in any rate proceeding.” (220 ILCS 5/7-101(3)) The Act requires Consumers to establish the prudence of its gas costs if it wants rate recovery for those costs. (220 ILCS 5/9-220(a))

Staff recommends that the Commission include a discussion in its final order of not only of Section 9-220(a) of the Act and the Commission’s standard for prudence, but also a discussion of the above underlined provisions in Section 7-101(3) of the Act.

## **II. UNCONTESTED ISSUES**

### **A. Gas Supply Purchases, other than those between Consumers Gas and Egyptian**

Consumers argues that “[i]t does not appear that Staff challenges Consumers’ gas supply purchases, other than those between Consumers and Egyptian.” (Consumers IB, p. 6) Consumers’ statement is only accurate with respect to the

prudence of gas purchases for purchases other than those between Consumers and Egyptian. Staff did take issue with the gas price used to calculate certain non Consumers and Egyptian gas purchases and the cost for transportation for certain non Consumers and Egyptian gas purchases.

Staff addressed those issues in the contested issues section of its IB in the Gas Price and Transportation sections (Staff IB, pp. 8-9) and again in this RB.

### **III. CONTESTED ISSUES**

#### **A. Unamortized Balances**

##### **1. Unamortized balance at 12/31/06**

Consumers argues that with respect to the unamortized balances issue, the Commissions findings with respect to this issue should be resolved consistent with Consumers' position on the hedging transactions between Consumers and its affiliate Egyptian. (Consumers IB, p. 6) Consumers' argument misses the point. As Staff set forth in its IB, Consumers reconciliation for 2007 failed to accurately reflect the Commission-ordered Unamortized Balance at December 31, 2006 from the 2006 reconciliation. (Staff IB, p. 6) The December 31, 2006 balance must reflect the amount ordered by the Commission in Docket No. 06-0744. The adjustment necessary to reflect the (\$193,441) from the Commission's Order for Docket No. 06-0744 is \$496. (Staff IB, Appendix 2, columns (c) and (d)) The Commission must reject Consumers' argument.

## **2. Unamortized balance at 12/31/07**

Consumers argues that the Commissions findings with respect to the unamortized balance at 12/31/07 should be resolved consistent with Consumer's position on the prudence of the hedging transactions between Consumers and its affiliate Egyptian. (Consumers IB, p. 6) Prudence is not the issue here. The issue concerns proper accounting. Staff in its IB argued that the Commission should adopt Staff's adjustment to include in the 2007 reconciliation the accrued interest on the unamortized under-recovery balance for the December 2007 period. Staff proposed an adjustment to increase the Unamortized Balance amount as of December 31, 2007, filed by Consumers to the amount shown on line 15, Schedule II of the Company's February 2008 PGA filing, which includes accrued interest. Consumers' reconciliation filing only included the Unamortized Balance of Factor A from line 13, Schedule II of the Company's February 2007 PGA filing, neglecting to include the interest on that unamortized balance. (Staff Ex. 1.0, pp. 3-4)<sup>2</sup> (Staff IB, pp. 6-7)

The Commission should reject Consumer's argument and adopt Staff's recommendation.

### **B. Commission Adjustment from Prior Order, Inclusion of O Factor**

Consumers argues that to the extent applicable, all findings by the Commission regarding this issue should be consistent with finding that the hedging transaction between Consumers and Egyptian were prudent. (Consumers IB, p. 6) Consumers

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<sup>2</sup> Staff Ex. 1.0 erroneously cited to Consumers' February 2007 PGA filing, which presents actual gas cost information for December 2006. The correct citations should be to Consumers' February 2008 PGA filing, which presents actual gas cost information for December 2007. However, the dollar amounts included in Staff's testimony and adjustment schedules reflect the intended December 2007 amounts which appear in the February 2008 PGA filing. The February 2008 PGA filing is attached to Staff's IB as Appendix 1.

misses the point of this issue. As discussed below, not all of Staff's adjustments relate to prudence of the hedging transaction between Consumers and Egyptian. The issue here is that the reconciliation filed by Consumers, due to the timing of the issuance of the Commission's final order in Docket No. 06-0744, did not and could not have reflected the Factor O ordered by the Commission in Docket No. 06-0744. (Staff IB, p. 7)

Staff's recommendation on this issue is simply that the reconciliation for 2007 should reflect the fact that the 2006 Factor O is an amount to be refunded in a future period. By including the 2006 Factor O in this reconciliation it will provide tracking of the 2006 Factor O until the reconciliation period in which it is refunded to ratepayers.<sup>3</sup> (Staff Ex. 1.0, p. 4)

## **C. Adjustment to Gas Costs**

### **1. Gas price**

Consumers argues that with respect to the Adjustment to Gas Costs – Gas price, the Commission's findings with respect to this issue should be consistent with a finding that the hedging transactions between Consumers and EGS were prudent. (Consumers IB, p. 6) Consumers fails to see that this is not a prudence issue. As discussed in the Staff IB, the transactions at issue involved a joint purchase by Consumers and EGS from Utility Gas Management ("UGM") in May and June 2006.<sup>4</sup> Rather than price the gas purchased at Consumers' portion of the purchase from UGM,

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<sup>3</sup> The 2006 Factor O plus interest were included by the Company in its determination of May 2011 PGA rates. (Staff Ex. 1.0, p. 4)

<sup>4</sup> While the purchases were made in 2006, the gas was not used by Consumers' customers until 2007 at which time the costs are then run through the PGA.



Consumers priced the gas as if it were a purchase from EGS via the Gas Sales Agreement (“GSA”) existing between Consumers and EGS, which it was not. This same mistake was made by Consumers in its 2006 reconciliation for which Staff proposed an adjustment and Consumers did not contest in that proceeding. (Order, Docket No. 06-0744, April 12, 2011, p. 3) (Staff IB, p. 8)

The Commission should reject Consumers’ argument and adopt Staff’s adjustment for \$(890). (Staff Ex. 1.0, Schedule 1.02, Line 3, Column D)

## **2. Transportation**

Consumers argues that with respect to the Adjustment to Gas Costs – Transportation, the Commission’s findings with respect to this issue should be consistent with a finding that the hedging transactions between Consumers and EGS were prudent. (Consumers IB, p. 6) Consumers fails to recognize that this is not a prudence issue. As discussed in the Staff IB and above, in May and June 2006, Consumers and its affiliate EGS made joint purchases of gas from UGM; however, transportation was paid separately to Texas Eastern Transmission, LP (“TETCO”). TETCO is the interstate pipeline company serving Consumers. Rather than Consumers and EGS each receiving a transportation bill for the volume of gas purchased, Consumers paid for all of the transportation for the joint purchases and then was reimbursed for a portion of the cost by EGS. The transportation costs reimbursed by EGS were not calculated on an equal weighting based on the volume of gas purchased by Consumers and EGS as they should have been. (Staff Ex. 1.0, p. 6)

The Commission should reject Consumers’ argument and adopt Staff’s adjustment for (\$6,401). (Staff Ex. 1.0, Schedule 1.02, Line 6, Column D)

**D. Hedging Transactions between Consumers and Egyptian****1. Consumers' hedging transactions with Egyptian were imprudent**

In its IB, Consumers asserts that Staff applies the wrong standard, a new standard, in determining whether Consumers' hedging transactions with Egyptian were prudent. Consumers argues that Staff's standard presumes that any transaction between Egyptian and Consumers is imprudent regardless of whether the transaction was actually prudent. (Consumers IB, p. 7) Consumers confuses the issue of whether the transaction is prudent with the controversy over whether the deal was authorized. Thus, Consumers seems to misunderstand the purpose of each Staff witnesses' testimony.

Since Egyptian is affiliated with Consumers, the hedging transactions between Consumers and Egyptian must be authorized by the Commission or as discussed above, the transactions are void. (220 ILCS 5/7-101(3)) Staff witness Lounsberry addressed the issue of whether the GSA previously approved by the Commission gave permission to Consumers to enter into the hedging transactions with Egyptian.<sup>5</sup> As set forth in Staff's IB and as discussed below, the GSA did not allow for such hedging transactions. (Staff IB, pp. 15-19)

In order for Consumers to recover the costs of the hedging transactions from ratepayers, not only did the hedging transactions between Consumers and Egyptian have to be authorized they also had to be prudent as "[t]he consent to, or exemption or waiver of consent to, any contract or arrangement under this Section or Section 16-111, does not constitute approval of payments thereunder for the purpose of computing

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<sup>5</sup> Staff witness Lounsberry also addressed the issue of even if the GSA authorized the hedging transactions, which it did not, did Consumers following the pricing provisions called for by the GSA, which Consumers did not. (See, Staff IB, pp. 20-21)

expense of operation in any rate proceeding.” (220 ILCS 5/7-101(3)) Staff witness Dr. Rearden considered the hedging transactions between Consumers and Egyptian. He applied the same standard for a prudence determination as cited to by Consumers (Consumers IB, p. 11) and as set forth in the Commission orders in Docket Nos. 84-0395 and 88-0142. That standard does not permit hindsight review, which Dr. Rearden did not use. The standard also recognizes that “reasonable persons can have honest differences of opinion without one or the other necessarily being ‘imprudent’ ” and that “only those facts available at the time judgment was exercised can be considered.” (Staff IB, p. 25) Despite Consumers’ arguments to the contrary, no reasonable person would have entered into the hedging transaction with Egyptian. Consumers argues that the hedging transactions could not have been accomplished more cheaply. To support its claim, Consumers places great reliance on the fact that the price of the hedge was based upon the NYMEX price at the futures settle price at the time the hedges were entered into. (Consumers IB, p. 14) However, rather than Consumers entering into the hedges with Egyptian, it could have entered into one of several transactions that cost significantly less than the \$11.51 per Dth Consumers agreed to pay Egyptian. (Staff IB, p. 29; Staff Ex. 3.0, pp. 9-10) For example, Consumers could have paid \$4.623 per Dth less by not entering into the transaction with Egyptian and instead locking in July purchases in May at \$6.887 per Dth as testified to by Dr. Rearden with no additional price risk cost. (Staff IB, p. 29) Dr. Rearden further testified that the information he relied upon for his analysis was readily available to the public and existed at the time that the decision was made by Consumers to enter into the hedging transactions. (*Id.*, p. 30)

Consumers contends that Dr. Rearden’s criticisms are inaccurate and wholly based upon hindsight. To support this claim, Consumers argues that it could not have

made the purchases recommended by Dr. Rearden because it did not have the storage capacity. (Consumers IB, p. 12) Dr. Rearden addressed this argument in his rebuttal testimony. Dr. Rearden testified that the same restrictions on contract storage rights that in Consumers view prevents the alternative purchases Dr. Rearden supported would have also applied to Consumers' hedge transactions with Egyptian. Yet somehow Consumers and Egyptian were still able to complete the transactions. (Staff Ex. 6.0, pp. 8-9) Consumers' argument is with out merit and should be rejected.

**2. Consumers had no authority to enter into the hedging transactions with Egyptian.**

Consumers argues that the hedging transactions between Egyptian and Consumers were authorized by the GSA. (Consumers IB, p. 9) The heart of Consumers' argument is that the GSA was silent on the issue of local gas sales. (*Id.*) Consumers' argument seems to be that because the GSA was silent on local gas sales, the non local gas sales, i.e. hedging transactions, were authorized. Consumers' argument in essence is that unless the Commission has specifically told a utility it cannot enter into a transaction then the Commission has granted authority to enter into such transaction. Consumers' position is contrary to the plain language of the statute which provides that no transaction is effective unless the Commission has consented to it. The burden is not on the Commission but rather the utility to identify the transactions it seeks Commission approval to enter into.

As Staff witness Lounsberry testified to and Staff addressed in its IB, the GSA was never intended to allow Consumers the ability to enter into a pre-purchase or hedging transaction with its affiliate. Instead, the original purpose of the GSA was to allow Egyptian the ability to sell local gas to Consumers. (Staff Ex 2.0, pp. 12-13) Local

gas is gas produced along Consumers' systems. (*Id.*, p. 13) Consumers expanded its interpretation of what type of activity the GSA allows it to conduct with Egyptian over time, a fact that Consumers does not dispute. (*Id.*, p. 15) Consumers fails to address the fact that the Commission addressed this very same issue just over two years ago.

The Commission most recently reviewed the same set of transactions in Consumers' 2006 PGA reconciliation in Docket No. 06-0744. The Commission in its order stated the following:

While Consumers argues that there was a GSA in place between Consumers and Egyptian which allowed the course of conduct in which Consumers engaged in 2006, the Commission suggests that the actions taken by Mr. Robinson went beyond what was authorized in the GSA. The Commission further notes that renewal of the GSA was considered by the Commission in Docket No. 08-0139, and the Commission rejected Consumer's GSA as not in the public interest. While the GSA was admittedly in effect during the time period in question in this proceeding, the actions taken by Mr. Robinson on behalf of Consumers and Egyptian appear to have stretched beyond recognition the actions allowed under the GSA.

(Order, Docket No. 06-0744, April 12, 2011, p. 24) As Staff pointed out in its IB, Staff recognizes that the Commission is not bound by prior decisions:

Initially we note that the decisions of the Commission are not *res judicata*. The concept of public regulation includes of necessity the philosophy that the Commission shall have power to deal freely with each situation as it comes before it, regardless of how it may have dealt with a similar or same situation in a previous proceeding. Thus like other administrative agencies, the Commission is free to change its standards so long as such changes are not arbitrary and capricious.

(*City of Chicago v. Illinois Commerce Commission*, 133 Ill. App. 3d 435, 440 (1st Dist. 1985) (citations omitted), and that the Commission must decide this case on the evidence in the record (220 ILCS 5/10-103, 10-201(e)(iv)(A)). However, on appeal, Commission decisions are entitled to less deference when the Commission drastically departs from past practice. *Business and Professional People for the Public Interest v.*

*Illinois Commerce Comm'n*, 136 Ill.2d 192, 228 (1989). In this case, Consumers provides no credible evidence for the Commission to decide this issue differently than it did in the 2006 PGA reconciliation.

**3. The Egyptian hedging transactions created significant benefit for the Egyptian to the detriment of Consumers' ratepayers**

Consumers maintains that the hedging transactions benefited ratepayers and consumers and were not designed to benefit Egyptian. (Consumers IB, pp. 13-14) Staff addressed this issue in detail in its IB. When C.A. Robinson decided to enter into the hedging transaction with Egyptian, it locked in a significant profit for Egyptian. This reduced Egyptian's business risk and provided at best a minor benefit to Consumers' ratepayers. (Staff IB, p. 22) At most, the savings to Consumers' ratepayers were \$5,350 due to the 5¢ per Dth discount mandated in the GSA (Staff Ex. 3.0, p. 7), while Egyptian gained a profit of up to \$700,000. (Staff IB, p. 23) Since C. A. Robinson negotiated both sides of the transactions, it appears that C.A. Robinson was motivated more by the potential profit for his unregulated affiliate Egyptian rather than the minor savings that the deal created for Consumers' ratepayers. (Id., pp. 22-23) In the end, the deal caused Consumers ratepayers to overpay for gas by the amount of \$295,363. (Staff Ex. 6.0, Att. DRT-3)

**E. Recommended Reconciliation and Factor O**

Consumers argues that with respect to the Reconciliation and Factor O, the Commissions' findings with respect to this issue should be consistent with a finding that the hedging transactions between Consumers and Egyptian were prudent. (Consumers IB, p. 15) As discussed above, Staff's proposed adjustments in this proceeding are not

all related to the sole issue of whether the transactions between Consumers and Egyptian were prudent. Staff's recommended reconciliation and Factor O are based upon adjustments related to a number of issues. More specifically Consumers: (1) failed to use the unamortized balance at 12/31/06 from the Commission's final order in Docket No. 06-0744 as the beginning balance on 1/1/07 for the 2007 reconciliation period, (2) failed to accrue interest on the unamortized under recovery balance for the December 2007 period, (3) failed to include in the 2007 reconciliation the Factor O ordered by the Commission in the 2006 reconciliation, (4) failed to properly price the gas purchased from UGM, (5) failed to allocate transportation costs to its affiliate on an equal weighting basis, and (6) entered into a hedging contract with its affiliate Egyptian which was neither prudent nor authorized by the Commission. Clearly, more than prudence is at issue in Staff's proposed adjustments to Consumers' reconciliation.

For the reasons made above and those set forth in the Staff IB, Staff recommends that the Commission accept Staff's reconciliation of revenues collected under the purchased gas adjustment clause with actual costs as reflected on ICC Staff Ex. 4.0, Schedule 1.01, Column (F), as set forth in Staff's IB, Appendix 2. Further, Staff recommends that the Commission direct Consumers to refund the Factor O amount of \$305,570 in the first monthly PGA filed after the date of the Final Order in this docket. (Staff Ex. 4.0, p. 6; Staff IB, Appendix 2, line 15, column F)

#### **F. Adequacy of Data Request Responses**

With respect to the issue of adequacy of data request responses, Consumers argues that it attempts at all times in good faith to supply the Commission and Staff with complete and accurate responses and will continue to do so in the future. (Consumers

IB, p. 16) Consumers' arguments notwithstanding, Staff recommends that the Commission order Consumers to continue to prepare its responses to Staff data requests in a more thorough and complete manner. Staff's recommendation is based upon the testimony of Staff witness Bridal and is consistent with what was ordered by the Commission in its Final Order in Docket No. 06-0744. (Staff Ex. 4.0, p. 6; Order, Docket No. 06-0744, April 12, 2011, p. 26)

#### **IV. CONCLUSION**

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this docket.

Respectfully submitted,

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